

# **Exhibit A**

S. HRG. 111-1061

# THE FINANCIAL STATE OF THE AIRLINE INDUSTRY AND THE IMPLICATIONS OF CONSOLIDATION

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## HEARING

BEFORE THE

### COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

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antee themselves bonuses and lucrative severance packages, then they can do the same for front-line employees. All cities that the airlines currently serve, not just profitable ones, must continue to be served. Pension obligations should be upheld in mergers, and consolidation should not be a vehicle for airlines to dump their pensions on the PBGC.

United and Continental would not be seeking to merge today if employees had not stepped up to save them in the past. United and Continental need to demonstrate how the proposed merger would benefit employees, consumers, and the cities and states the airlines currently serve.

Thank you again for the opportunity to speak with you today. The Machinists Union recognizes it is in the Nation's interest to have a safe, reliable, competitive and profitable air transportation industry. We are committed to working with Congress, the Departments of Justice and Transportation, and the air carriers to achieve that goal.

I look forward to your questions.

The CHAIRMAN. Thank you. And good timing.

Mr. Charles Leocha, who is the Director of the Consumer Travel Alliance.

Please, sir.

**STATEMENT OF CHARLES LEOCHA, DIRECTOR,  
CONSUMER TRAVEL ALLIANCE**

Mr. LEOCHA. Thank you, Chairman Rockefeller and Ranking Member Hutchison, for giving passengers a seat at this table.

My name is Charlie Leocha, and I am the Director of the Consumer Travel Alliance, a nonprofit created to keep the needs of consumers in front of legislators, regulators, and staff here in Washington. Our Alliance is a member of the Consumer Federation of America.

My testimony today focuses, of course, on United and Continental Airlines' proposed merger. According to news reports, these airlines are already forming a steering committee and establishing teams of employees to delve into details of aligning. "Whoa, Nelly," as we say back in my neighborhood, "It ain't a done deal yet."

The Consumer Travel Alliance cannot find any public benefit from this merger. There are no new destinations, no new savings passed on to passengers. We see customer service disruptions and more-restrictive frequent flyer programs. Ultimately, we believe consumers will be faced with less competition and higher prices.

In addition, thousands of small businesses and corporate travelers will face difficult negotiations with a mega-airline larger than any our Nation has ever known before.

The merger plan acknowledges thousands of employee layoffs when our economy is already under stress. Our Nation is now faced with two forms of consolidation: the traditional merger of two airlines, and the development of alliance antitrust immunity that allows multiple airlines to operate as one, internationally. Neither this merger nor antitrust immunity are in the consumer's interest. I don't think that any of us in this room can point to even one single public benefit from the latest airline mergers. Bankruptcy for both airlines has already squeezed costs and capacity out of the system. This merger will only squeeze competition out of the system.

Though Continental and United already work together as alliance partners, they still compete aggressively in many areas. They fight for corporate and leisure travelers. They compete for airline

gates. They compete for frequent flyers, suppliers, travel agency attention, and much more.

The Department of Justice should conclude that the proposed merger is not in the public interest, just as they did a year ago, when reviewing the application from these same two carriers for airline alliance antitrust immunity. DOJ's reasons for denial included consumer harm, higher fares, elimination of competition, and, ultimately, that it was not in the public interest. Nor is this merger.

This union, however, ups the ante. Should this merger be approved, the Nation's system of network carriers will be effectively reduced to three: Delta, United, and American. This trio, even without U.S. Air, which is already rumored to be exploring a merger with American, would control more than 70 percent of the domestic market, if associated regional airlines are included. And their alliances would control 85 percent of international traffic. We are creating yet another industry with companies too big to fail. Have we learned nothing from the past 2 years?

Admittedly, these two airlines have limited overlapping routes. However, their impacts on hubs, long-haul routes, connecting routes, suppliers, and consumers cannot be measured by overlapping routes, alone. The potential impact of this merger should be examined through the long-term prism of our country with only three major network airlines. It will be a consumer nightmare.

Much has been made of the price discipline exercised by low-cost carriers. Maybe so for point-to-point competition. But, flights to smaller airports and to international destinations served by these carriers and their alliances will not face any pricing pressure from low-cost carriers. And that connecting traffic is exactly what these hub-and-spoke carriers are all about.

In summary, this continued consolidation may be helping large airlines survive in the short run, but, when the economy improves, consumers, both leisure and business, will be left at the mercy of a government-approved system of airline oligopoly with less competition and, ultimately, higher airfares.

If airline consolidation is allowed to continue, with mergers in domestic—of domestic carriers and antitrust immunity, the Consumer Travel Alliance predicts that this committee will find itself, within the decade, meeting to find ways to restore competition that is being eliminated today.

America's airline passengers thank you for this opportunity, and I look forward to questions.

[The prepared statement of Mr. Leocha follows:]

PREPARED STATEMENT OF CHARLES LEOCHA, DIRECTOR,  
CONSUMER TRAVEL ALLIANCE

Thank you, Chairman Rockefeller for giving passengers a seat at this Congressional table and an opportunity to testify about the effects on consumers of today's airline consolidation.

My name is Charles Leocha and I am the Director of the Consumer Travel Alliance, a nonprofit created to keep the needs of consumers in front of legislators, regulators and their staff. Our alliance is a member of the Consumer Federation of America. We are intimately involved with the current conference committee negotiation over the FAA Reauthorization. We are also working with state regulators, the FTC and DOT on privacy issues, travel insurance, pressing consumer issues with online and traditional travel agents and in the area of travel rights.

My testimony today focuses on the effects of the merger of United Airlines and Continental Airlines. I will also address the ongoing effects of consolidation in the airline industry that has been taking place for more than a decade. I am not speaking only for leisure travelers who make up more than 80 percent of airline passengers, but also for business travelers who provide more than 50 percent<sup>1</sup> of airline revenues.

Though these two airlines have many cooperative agreements, they still compete aggressively with each other in many ways—for corporate and leisure travelers, airline gates, frequent fliers, suppliers, travel agency attention and more.

We believe the Department of Justice and Congress should conclude that the proposed merger is not in the public interest, just as they did in June of last year, when reviewing the application from these same two carriers for airline alliance antitrust immunity.<sup>2</sup>

DOJ's reasons for denial included consumer harm, higher fares and elimination of competition, and ultimately that it was not in the public interest. Those same concerns resonate with this corporate marriage, but this union ups the ante—approval would make a third domestic merger almost inevitable.

### **The Road to Three Big Carriers**

Should this merger be approved, the Nation's system of network carriers will be effectively reduced to three major players—Delta, United and, perhaps, a coming mega-carrier formed by the merger of American Airlines with another airline. Even without the American merger with another carrier, this Delta/United/American triumvirate would control more than 50 percent of the U.S. domestic available seat miles (ASMs) and revenue passenger miles (RPMs).<sup>3</sup> Their airline alliances would control 85 percent of international traffic.<sup>4</sup> That kind of consolidation might bode poorly for business travelers as well as leisure travelers and may lead to another industry with its major players considered “too big to fail.”

A merged United-Continental initially would have about 90,000 employees and about 700 aircraft, which certainly means higher odds of government bailouts or assistance than if the carriers operated individually. On the other hand, today, if one of these two airlines crumbled, the national air transportation system would shudder, but hardly be crippled.

### **Are There Benefits for Consumers?**

The Consumer Travel Alliance cannot find any tangible consumer benefits of this merger and the ongoing consolidation in the airline industry. There are no new destinations, no new savings passed on to passengers and ultimately consumers are faced with less competition and higher prices. Consolidation to this point has already made airline signaling of airfare changes easier. This merger will make the process of raising airfares even simpler. The continued application of fees and the unbundling of airfares will also accelerate with fewer airlines in competition with each other. The institution of fees for checked baggage, seat reservations, meals and more has been followed by airline after airline like a herd of wildebeests crossing a crocodile-infested river.

To be sure, there are plenty of corporate benefits—reducing the combined work force, certain economies of scale and increasing bargaining power (at the expense of suppliers). But business and leisure travelers don't get anything more than what they have been experiencing through the already coordinated international schedules, shared frequent flier miles and awards and visitation privileges at airport clubs.

Even United and Continental spin-doctors are having trouble finding specific consumer benefits from the merger now under consideration. On their merger website, they have touted supposed consumer benefits that are nothing new. We have all seen the following platitudes they cite for decades<sup>5</sup>—

#### *World's Most Comprehensive Network*

In reality, this is no benefit for consumers. At best, the Continental/United network remains identical to the current network operative through the Star Alliance. Potentially, there will be consolidation of overlapping routes. Though few routes

<sup>1</sup> PhocusWright.

<sup>2</sup> Joint application to Amend Order 2007–2–16 under 49 U.S.C. §§ 41308 and 41309 so as to Approve and Confer Antitrust Immunity, Comments of the Department of Justice on the Show Cause Order Docket OST–2008–0234 pg. 42.

<sup>3</sup> AirlineForcasts.com Commentary: United + Continental is a big win for all stakeholders by Paul Mifsud, Carlos Bonilla, Vaughn Cordle, CFA.

<sup>4</sup> Bureau of Transportation Statistics.

<sup>5</sup> <http://www.unitedcontinentalmerger.com/benefits/customers>.

overlap, the final honest assessment is a reduced network and fewer choices for both business and leisure travelers.

Just as Delta swore that it would not abandon its hub at Cincinnati, current Continental statements about the sanctity of their Cleveland operations must be taken with a grain of salt. Everyone in this room realizes that the reduction of flights were made in Cincinnati and that future reductions of flights from Cleveland will be made because of consumer demand, or the lack thereof. However, without the merger of Delta with Northwest and the proposed merger of Continental with United, Cincinnati probably would still be thriving and there would be no discussions about downsizing Continental's Cleveland operations.

#### *World's Leading Airline*

When has this been a benefit to consumers? The combination will have the same planes it currently is flying. The merged carrier will have the same frequent flier program that is already aligned through alliance membership.

#### *Competitive Fares*

United/Continental claim that 92 percent of their top 50 major city routes have low-cost-carrier competition. That competition will guarantee low fares. The real change in competition will be in the field of business travel. There, this consolidation will have drastic effects on corporation travel programs that depend on hubs where CO/UA price competition will be eliminated.

When corporate travel departments are faced with both a new paradigm presented by this merger plus the developing might of international alliances that are beginning to negotiate as a single entity rather than as a dozen or more separate airlines, competition will be further degraded.

#### *Award-Winning Customer Service*

If past history provides any gauge consumers can expect a decrease in overall customer service when highly rated Continental merges with poorly performing United Airlines. It appears certain the Continental passengers will see degradation in the service levels that they have come to expect.

According to DOT's Airline Quality ratings that measure complaints, misdirected baggage and on-time arrivals, Continental has ranked at the top of the major airlines for the past 3 years (if we take out Northwest that merged with Delta). United Airlines has been mired near the bottom of the rankings for the past 2 years, only excelled in poor customer service by Delta that has not budged from last place even as it absorbed the former customer-service champion, Northwest Airlines.

In fact, customer service will be an unknown as Continental's vaunted service is merged with United's marginal service; a chance of reduced morale among Continental employees as their contracts are reduced to meet United pay levels is expected. From the consumer point of view, this bigger-is-better argument has no basis in reality.

Historically, airline mergers have created a quantum increase in customer service problems. Of course all of these problems can be "worked out," however they subject consumers to additional headaches and travel disruption. One of the most frustrating is the consolidation of passenger data. Every recent merger from the days of the Continental/People Express to the Delta/Northwest mergers has been fraught with IT problems.

#### *Industry-Leading Frequent Flier Program*

These programs are already merged from an award-city point of view. The most likely result of this merger will be a shift to more passenger-unfriendly rules such as hefty co-pays for upgrades. Having these frequent flier programs consolidated will allow the Big 3 airlines to more easily make anti-consumer changes. Competition between frequent flier programs is another form of competition that will be eliminated.

The bottom line: If what has happened in the past provides a roadmap to consequences of this pending merger, Consumers will see no benefits and may face degraded service, less competition, more fees and higher prices. Plus, possible changes to current frequent flier rules may raise mileage costs for redemption of miles and reduce free travel opportunities rather than increase them.

#### **Airline Consolidation by Merger**

This proposed merger of United Airlines and Continental Airlines is the latest portion in a continuum of airline consolidation that has been slowly taking place over the past decade.

Mergers have been with the airline business for decades, however the size of these mergers is now creating airline behemoths that couldn't even be contemplated only

a decade ago. Continental merged with People Express, Northwest merged with Republic, US Air merged with Allegheny, American merged with Reno Air and then TWA and last year Delta merged with Northwest to create what is the world's largest airline.

Now, Continental and United stand before the Department of Justice and Congress with a merger that will create even a larger airline.

#### **Airline Alliance Consolidation**

As domestic airlines have been merging, internationally mergers have also taken place. However, the granting of antitrust immunity that allows certain airlines to do unrestricted business together has changed the economic playing field.

It started with the granting of antitrust immunity for Northwest Airlines and KLM Airlines back in the early 1990s in order to encourage European countries to negotiate Open Skies agreements with the U.S. This initial antitrust immunity grant was issued in the "public interest" for a greater good.

However, airlines discovered that antitrust immunity added significantly to the bottom line and though, today, we have Open Skies agreements with most European countries, the alliance antitrust immunity has continued to grow, not for the public good, but for corporate good.

These antitrust immunity grants have accelerated with the creation of three major airline alliances between the world's largest carriers. Lufthansa, United, US Airways, and Singapore airlines and others form the Star Alliance. American Airlines, British Airways, Iberia, Finnair, Qantas and others make up the OneWorld alliance. Delta, Northwest, Air France, KLM, Korean Air and others have created SkyTeam. Already, DOT has granted SkyTeam and Star Alliance antitrust immunity and the OneWorld alliance has applied for similar antitrust immunity.

This antitrust immunity allows alliance airlines to work together as a joint venture with a separate board of directors. Alliances are already jointly coordinating flights, schedules, route planning, marketing efforts, advertising, sales campaigns, frequent flier programs, catering and maintenance. These alliances are defacto mergers of the alliance's international business.

#### **An Increase in Airfares**

This merger needs to be looked at far more expansively than simply overlaying one route structure over another and then congratulating each other at the lack of overlapping routes. I admit that there are few overlapping routes between these airlines. When competition is taken out of the market it affects every route that an airline flies whether it overlaps with its merger partner or not. Investigators also need to examine nonstop flight markets as a separate and distinct market from connecting flights between city pairs.

#### *Consider These Scenarios*

First: With one less major network carrier, in an oligopolistic industry, the airline system of trial airfares has one less player. With one less "veto vote" available to reject system-wide fare increases the chances of consumers having to pay more in terms of airfares and airline fees increases exponentially.

Second: The merger also needs to be examined in light of today's airline alliances that already give Continental/United a joint venture for their transatlantic, Latin American and transpacific schedules and route structures. These joint ventures provide this merged carrier a government-approved system to profit from limited international competition and then use that profit to squeeze domestic competitors who do not have such government-assisted antitrust immunity provisions that virtually guarantee profits on international routes.

#### **Effective Business Travel Monopolies at Select Hubs**

The effects of the United/Continental merger will have far-reaching negative consequences for business as well as leisure travelers if it leads to a consolidation of the network airlines into three groups. When one of these mega-carriers controls the hub of a corporation, there is no competitive mega-carrier to limit the dominant hub airline's pricing power. Corporate air travel buyers will be forced to capitulate. This situation gets even worse when the dominant hub airline is linked with an international alliance and that alliance demands that corporations bargain with the alliance as a single joint venture rather than playing one airline off against another.

This kind of dominant hub power allows the mega-carrier to control prices for consumers and commissions that they pay travel agents. It affects far more than only business and leisure travelers. It affects new competition as well. Entry into a route that is anchored by a major carrier hub on both ends is extremely difficult for would-be competitors. Suppliers also face the difficulty of bargaining with the domi-



nant mega-carrier from a real position of weakness. The resulting situation is anti-small-business in the hub airport community.

These major carriers also use mergers as a way to consolidate control of airport gates and in some cases take-off and landing slots. These kinds of gate and slot controls can make penetration by low cost carriers very difficult. Washington Reagan only recently has seen new low cost carriers (JetBlue will startup in November) because of limited take-off and landing slots.

At Boston Logan Airport, AirTran's operations were limited for months because they could only secure one gate while Northwest hoarded its gates simply to keep competition out of the airport. As we hold this hearing, Southwest Airlines is attempting to gain slots at both La Guardia and Washington Reagan so that they can compete with entrenched network carriers.

While many analysts and airline CEOs claim that three is the perfect number of large network competing airlines, that perfection in terms of competition only works if all three airlines have relatively equal strength across all markets. When market power is allowed to be concentrated in different hubs, the system is really a divide-and-conquer strategy. This fortress hub system is being played in every city where mega-carriers face minimal competition—Houston, Detroit, Minneapolis, and Dallas. Cities where two competing network carriers have hubs see much healthier competition—New York City, Los Angeles, Chicago.

#### **Low-Cost Carriers, the Competition Antidote**

The only real airline pricing discipline is generated by competition from low-cost carriers. The travel industry has documented the "Southwest Effect." This is a three-step effect where first, lower fares increase demand; second, competing airlines match the Southwest fares; and third, sales rise for all airlines in the market.

This kind of competition can only take place if there are available gates at airports and available take-off and landing slots. Both factors must be considered carefully by DOJ while examining this pending merger as well, just as DOT has when considering recently proposed take-off/landing slot swaps between airlines.

On the transatlantic front, Open Skies agreements with the European Union (E.U.) may offer potential avenues for effective low-cost airline penetration when the low-cost airlines decide to expand internationally. Just as low-cost airlines began their move into the domestic market by serving less-popular airports, their expansion into transatlantic flying is dependent on a good Open Skies agreement since major hubs—Heathrow, Frankfurt, Amsterdam, Paris and Madrid—are locked up by the mega-airline alliances.

#### **Conclusions**

From a consumer perspective, this continued consolidation may be helping large airlines survive in the short run but when the economy improves, consumers—both leisure and business—will be left at the mercy of a government-approved system of airline oligopoly with less competition and, as a result, according to Department of Justice analysis, ultimately higher airfares.

In the short-term, approval of this merger may not be seen as anti-competitive, but as a form of welfare for struggling airline corporations. In the long term, there is no doubt that effective airline competition will be eliminated and that a market with less competition is less consumer friendly.

If airline consolidation is allowed to continue along its current path with mergers of domestic carriers and antitrust arrangements for groups of international airlines, the Consumer Travel Alliance predicts this committee will find itself, within the decade, meeting to find ways to restore competition to airline system that is being eliminated today.

The CHAIRMAN. Thank you very much.

And now, Mr. Dan McKenzie, who is an industry analyst from Hudson Securities.

#### **STATEMENT OF DANIEL MCKENZIE, SENIOR RESEARCH ANALYST, HUDSON SECURITIES**

Mr. MCKENZIE. Good morning. Mr. Chairman and members of the Senate Commerce Committee—

The CHAIRMAN. Can—is your machine on, there?

Mr. MCKENZIE. OK.